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## **Competitiveness and the EMU: At the roots of the Euro-zone crisis**

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### **Introduction**

In this article, the sovereign debt crisis, affecting the so called 'PIIGS' group (made up of Portugal, Ireland, Italy, Greece and Spain), is inserted within the context of the structural imbalances characterising the EMU from the start (Similarly Krugman 2012; DeGrauwe 2013; Eichengreen 2014).

The main argument is that the global financial crisis, given the structural differences of the different Euro-area members States, hit the different states in different ways, de facto acting as an asymmetric shock. This exacerbated the structural problem of competitiveness inherent to the way in which the European Currency Union was conceived. As such, the sovereign debt crisis can hardly be read as merely a fiscal crisis. On the contrary, it was the result of an already existing problem of sustainability of a structurally asymmetric monetary union made more serious by the economic shock represented by the global financial crisis.

In a way, the Global Financial crisis acted as a catalyst of the already existing imbalances embedded in the EMU, signalling to the financial markets which countries to speculate against (Chang and Leblond 2015). Speculation continued unhindered until when, eventually, the ECB decided, or was allowed to act, as a de facto lender of last resort.

This article is concerned with the above issues starting with addressing the unfolding of the Euro-zone crisis and its nature. It will then assess to what extent Euro-zone member states faced competitiveness threats exacerbated by the outburst of the global crisis. Finally it will focus on the reactions of EU Institutions, and, in particular, on the role of the ECB as a "hidden" lender of last resort.

### **The role of the Global Financial crisis**

There is no doubt that the global financial crisis represented a substantial blow to the global economy, leading to wide-ranging and long lasting consequences.

In the literature there is a tendency to distinguish five stages in the unfolding of the global financial crisis (Orlowski 2008). If the first stage is clearly represented by the collapse of the US subprime mortgage market, this was followed by a credit crunch leading to a liquidity crisis. The subsequent phase was a commodity price bubble and finally the demise of investment banking in the US (Orlowski 2008).

Although the bail out of financial institutions by national governments all over the globe did avoid the global financial meltdown, by that time the global financial crisis had already provoked a global economic crisis (Talani 2010). Just two years after the collapse of Lehman Brothers, the global economy had experienced its sharpest ever decline of the GDP, going from 5.2 per cent to -0.8 per cent (Sinn 2010:6).

This was particularly serious in the euro-zone, where the GDP fell by an unprecedented 9%, from 3.8% in 2007 to -5.2% in 2009, with Ireland being the first euro-zone country to technically enter into recession in September 2008 (Sinn 2010:6).

Finally, the Euro-area experienced a sovereign debt crisis starting in Greece, in May 2010, moving to Ireland at the end of November 2010, and eventually to the other members of the so-called PIIGS group (including Portugal, Ireland, Italy, Greece and Spain).

The first country to be attacked by speculation was Greece in May 2010, immediately after Moody's downgraded its debt<sup>1</sup>. If this can be considered a signal to the markets to start attacking a country (Chang and Leblond 2015), it certainly did not help that the reaction of EU institutions took a long time and resulted in the mere establishment of an *ad hoc* European Financial Stability Facility. This was a temporary and underfunded initiative, that, instead of quashing the markets' thirst for speculation, might have even excited it (DeGrauwe 2013).

In fact, by November 2010 financial markets were targeting Ireland. The country was then still plagued by the crisis of its banking system and, despite the fact that the EU had decided to approve a rescue package for €85 billion, which included €35 billion to bail out the Irish banking system and € 50 billion in support the government's day-to-day spending, financial markets did not seem satisfied. They kept on selling Irish bonds, together with the Greek, Portuguese, Spanish and Italian ones, thus substantially increasing the yields paid on them<sup>2</sup>. As the situation worsened, threatening to bring the entire system to collapse, on 16<sup>th</sup> and 17<sup>th</sup> December, 2010, the European Council, amid serious worries for the stability of the entire system, decided to institutionalise the European Stability Mechanism, a rescue measure officially launched on 8<sup>th</sup> October 2012<sup>3</sup>.

Indeed, there was no possibility of mistaking the seriousness of the euro-zone situation. A report of the ECB of December 2010 identified in the interplay between sovereign debt difficulties and the weakness of the banking sectors of some countries a potentially disruptive threat for the sustainability of the whole Euro-zone<sup>4</sup>.

The assessment of the ECB differentiated between the sources of instability for the EMU outside the financial system and risks existing inside it<sup>5</sup>.

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<sup>1</sup> See BBC News, available at <http://news.bbc.co.uk/2/hi/business/8671632.stm> as accessed on December 22, 2010. See also below this chapter.

<sup>2</sup> See BBC News, available at <http://www.bbc.co.uk/news/business-11860879> as accessed on December 22, 2010.

<sup>3</sup> See BBC News Q&A: *The European Stability Mechanism*, available online <http://www.bbc.co.uk/news/business-19870747> as accessed on October 9, 2012

<sup>4</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>5</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

The outside sources of concern were given by macroeconomic imbalances between the different member states, which were reflected in the increase in unemployment levels and the related reduction of credit to private economic actors. This was accompanied by the re-emergence of global imbalances, and some residual concerns about the fiscal stances of some of the Euro-zone member states. Clearly fiscal concerns were not the only source of troubles identified by the ECB at the height of the sovereign debt crisis and macroeconomic imbalances both within and without the euro area featured extensively among the problems to worry about. Also the risks identified inside the financial system included the possibility of more volatility of financial markets in the lack of macroeconomic recovery.<sup>6</sup>

Indeed, the ECB identified an adverse feedback loop between economic recession, the credit crunch and fiscal imbalances, which was at the roots of the persistently increasing spread between euro-zone sovereign bond yields<sup>7</sup>. That the problem had shifted from the financial side to the real economy was further demonstrated by the fact that in the second and third quarters of 2010, the profitability of many euro-zone large and complex banking groups (LCBGs) had continued recovering<sup>8</sup>. Final concerns were expressed in relation to global financial imbalances that, if emerged again, could create new threats to the fiscal and financial positions of some countries within the EMU<sup>9</sup>.

If the analysis of the ECB was clear enough, the solutions identified by EU Institutions did not seem to be able to stop the crisis, to the extent that in July 2011 the Greek, Irish and Portuguese spreads with the German Bund hit, respectively, 1600, 1200 and 1100 basis points. Equally, the Spanish and Italian sovereign debt spreads with the Bund reached 400 basis points, Belgium hit 200 basis points and France hit 90 basis points<sup>10</sup>.

By 2012 Spain had to accept around 100000 mn Euros as a sort of bail-out for its banking sector on the verge of bankruptcy and Italy had been so heavily attacked by the markets that a rescue operation was avoided only at the very last minute<sup>11</sup>.

### **Fiscal imbalances inside and outside the Euro-Zone**

The fiscal profligacy of the PIIGS (as referred to in DeGrauwe 2013) has been often blamed for the Euro-zone crisis. Regarding this, it is difficult to deny that some of the countries affected by the wave of speculation against their sovereign debt in 2010/11 had had in the past, and were still having at the time, compromised fiscal situations. However it is worth noting that the fiscal stimulus and bail-out of the financial system came at a high price also

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<sup>6</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>7</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>8</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>9</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>10</sup> ECB (2010) *Financial Stability Review* available online at <http://www.ecb.int/pub/fsr/html/summary201012.en.html> accessed on December 22, 2010.

<sup>11</sup> See Financial Times, June 13<sup>th</sup> 2012:, available at <http://www.ft.com/cms/s/0/d2d42d1e-b36c-11e1-83a9-00144feabdc0.html#axzz1xfURTAr3> as accessed on June 13, 2012

for the budgets of other countries, which were not singled out by the financial markets.

For example, in 2009 the first Obama administration approved a stimulus package of \$800 billion, raising the deficit to GDP ratio to 10 per cent. Similarly, Japan recorded a 10 per cent deficit to GDP the same year and in the UK the deficit to GDP achieved the astounding level of 13 per cent.

On the other hand, the euro-zone average deficit to GDP was only 6 per cent in 2010, lower than its average level of more than 7 per cent in the mid-1990s<sup>12</sup>. Obviously different countries in the euro-zone had different performances of their deficits to GDP. However looking at the countries which were eventually interested by the sovereign debt crisis some points needs to be noticed.

First of all, not all countries which were under fire by financial markets had been experiencing a bad performance of their deficit to GDP during the crisis.

To start with Greece, in 2010, at the onset of the sovereign debt crisis, the country had a deficit to GDP, which was only 4.3% above the 6 per cent average of the euro-zone. Equally, Portugal and Spain had a deficit to GDP just about 3.8% and 3.3% above that average, at 9.8% and 9.3% respectively. To be sure, Italy had even achieved a lower than average deficit to GDP during the global financial crisis, reporting a figure of 5.4% in 2009 and only 4.6% in 2010<sup>13</sup>.

Of course, looking at the performance of the debt to GDP the picture for Italy changes. However it is not meaningless to underline that in 1995, when Italy was qualifying to enter the EMU in the first round, the debt to GDP ratio was a good 49% above the average of the future euro-zone, at 121.5% against an average of 72.5%. On the contrary, in 2010 Italy had managed to shrink this gap to only 34%<sup>14</sup>. Still looking at the debt to GDP ratio, in 2010 Spain was actually faring much better than the average of the euro-zone with a debt to GDP ratio of 61.2% much below the euro-zone average of 85.2%. Equally, Ireland and Portugal were just above such an average with ratios of 92.5% and 93.3% respectively<sup>15</sup>.

Looking at the general government consolidated debt, it is clear that also Germany and the UK had dramatically increased it in the period considered and that, in terms of total amounts, Germany's debt was equal to the Italian one. Of course one needs to consider the size of the economy.

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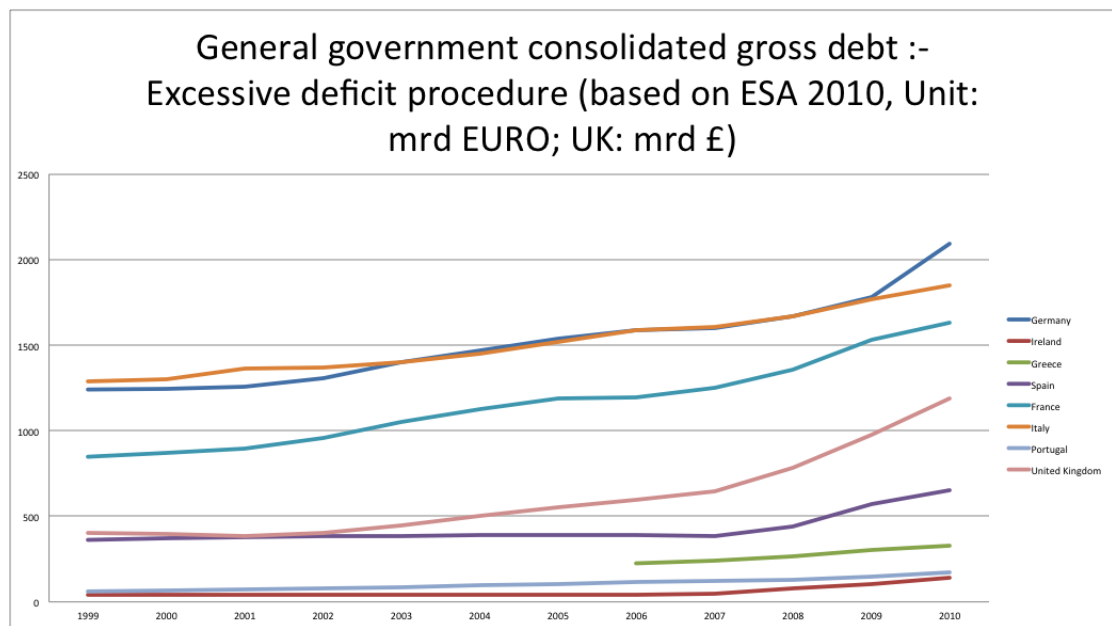
<sup>12</sup>See ECB statistics, available at <http://www.ecb.int/stats/gov/html/dashboard.en.html> as accessed on October 9, 2012

<sup>13</sup>Ibid.

<sup>14</sup>Ibid.

<sup>15</sup>Ibid.

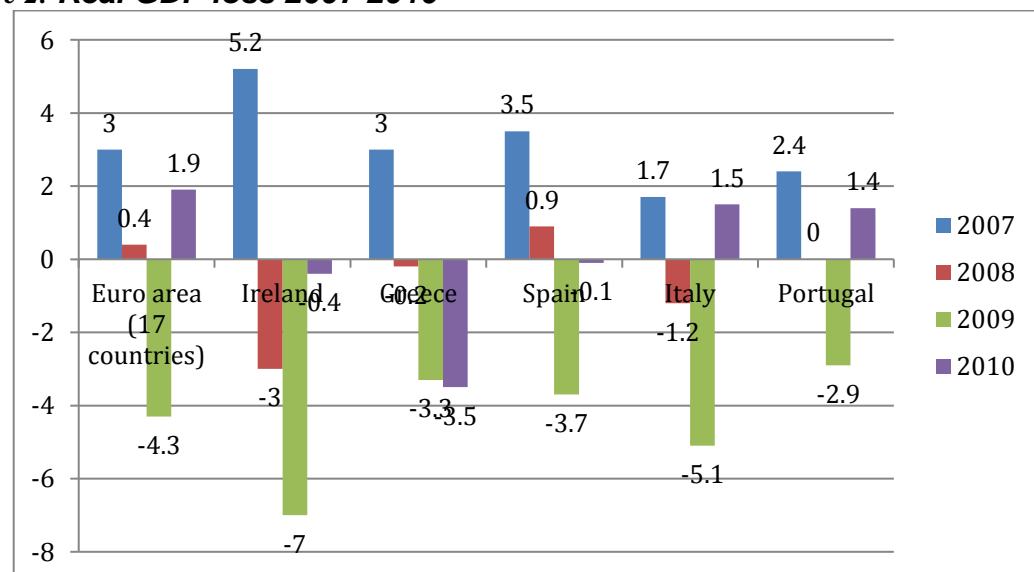
**Figure 1: General Government consolidated gross debt**



Source: AMECO

Equally, however, all the above fiscal indicators have to be assessed within the context of the unprecedented decline in GDP which by definition, even only for pure mathematical reasons, but also for economic and political ones, increases the debt and deficit to GDP ratios. Just to be clear, in the period between 2007 and 2009, Ireland lost 12.2 % of its real GDP, Greece 6.5%, Spain 7.2%, Italy 6.8% and Portugal 5.3% (Figure below).

**Figure 2: Real GDP loss 2007-2010**



Source: EUROSTAT elaboration of the author



So if the euro-zone crisis cannot easily be conceptualised as a fiscal crisis, what was its true nature?

### **The role of asymmetric shocks**

One might speculate at length, as it indeed is done in the literature (Krugman 2012, DeGrauwe 2013, Eichengreen 2014) on what exactly was the asymmetric shock that hit the euro-zone on the eve of the sovereign debt crisis signalling to the market that the time was ripe to increase the stakes on weaker countries credibility. It is however difficult to deny that something unforeseeable and difficult to control had indeed happened previous to the crisis of the euro-zone. As we highlighted above that was, clearly, the global financial crisis (GFC) of 2007/08 leading to the ensuing global economic crisis of 2009/10 (GEC). It is therefore not unconceivable to hypothesise that indeed the element that tilted the already precarious balance of the EMU on the side of the crisis might have been precisely represented by the events of 2008/2009. In a way, we could consider the GFC and the following GEC as a sort of symmetric shock. This, however had different effects in different Euro-zone countries given the asymmetries existing before the creation of the Euro-zone which the EMU, instead of reducing, as sometimes forecasted by the economists (Artis et al 2011), contributed to exacerbate.

This interpretation is consistent with a number of contributions, which had stressed, at the eve of the establishment of the EMU, how the monetary union itself could create more imbalances than it would help to recuperate.

For example, Frankel and Rose (1998), before the EMU came into place noted that extending monetary integration could lead to changes in the industrial structures of the countries participating in it. This is something that Mundell had identified as a problem to keep a monetary Union (Eichengreen 2014:4-5). The rationale behind this increase in discrepancies between the members of a currency union is that, by increasing inter-industry trade, the monetary union might bring more regional specialisation, heightening the probability that asymmetric shocks would happen or that a single symmetric shock

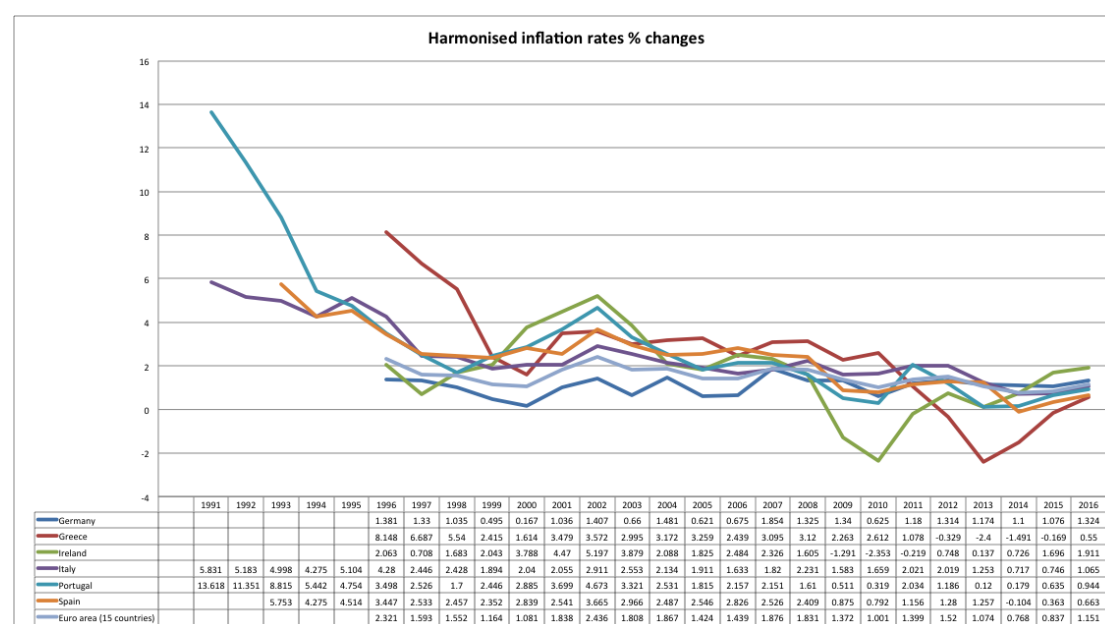
An even more relevant source of concern was, however, represented by the so-called “Walters critique” (1990), a theory which had already been brought into question to explain the crisis of the ERM of the EMS in 1992 (Talani 2000). This critique posited that, despite the currency union, inflation rates would not converge across the members of the EMU. In particular, in the periphery of the EU inflation rates “would continue” to be higher than in the rest of the EMU. It is important to stress that inflation rates in the so called PIIGS countries had indeed always been higher than in the core countries. And, according to Walters, they will continue to do so. This point is a vital one to counter a very widespread interpretation of the increase in the inflation rates of peripheral countries within the EMU as a consequence of the overheating of their economies ensuing from the fact that they could enjoy lower interest rates. Eichengreen (2014), for example, notices that indeed Walters (1990) was right because peripheral countries of the EMU experienced spending booms at home, reflected in souring construction spending (Ireland, Spain), consumption spending (Portugal) and government spending (Greece) because of the fact that borrowing became less expensive

(Eichengreen 2014:4-5). Similarly, DeGrauwe (2013:6-7) seems to believe that inflation in the PIIGS picked up after the establishment of the EMU, when low interest rates enjoyed as a result of a single monetary policy produced an unsustainable expansion of the economy.

In fact, and this is the point, inflation rates of peripheral countries had always been above the rest of the Euro-zone ones, especially Germany's. To be sure, harmonised inflation had not increased because of the availability of cheaper credit within the EMU. The Walters' critique, in sum, was not activated by the establishment of the EMU. It was already valid before the currency union came to existence!

Looking at the performance of the harmonised inflation rates of the PIIGS from 1991 it indeed emerges pretty clearly that they all kept higher inflation rates than Germany or even of the average Euro 15 until 2009. This dynamic, however, was not a novelty introduced by the EMU, but confirmed a reality which already existed before the establishment of the EMU, when inflation rates were actually much higher! (See figure below).

**Figure-3: Harmonised Inflation rates % Changes 1991-2009, PIIGS and Germany**



Source: OECD on-line database as accessed on January 18, 2016

would have different effects in different regions.

In the literature (Sinn 2014), it is often claimed that similar structural imbalances require “internal devaluation” policies, or supply-side policies to be countered, which means increasing competitiveness by reducing labour costs, either reducing wages and/or increasing productivity.

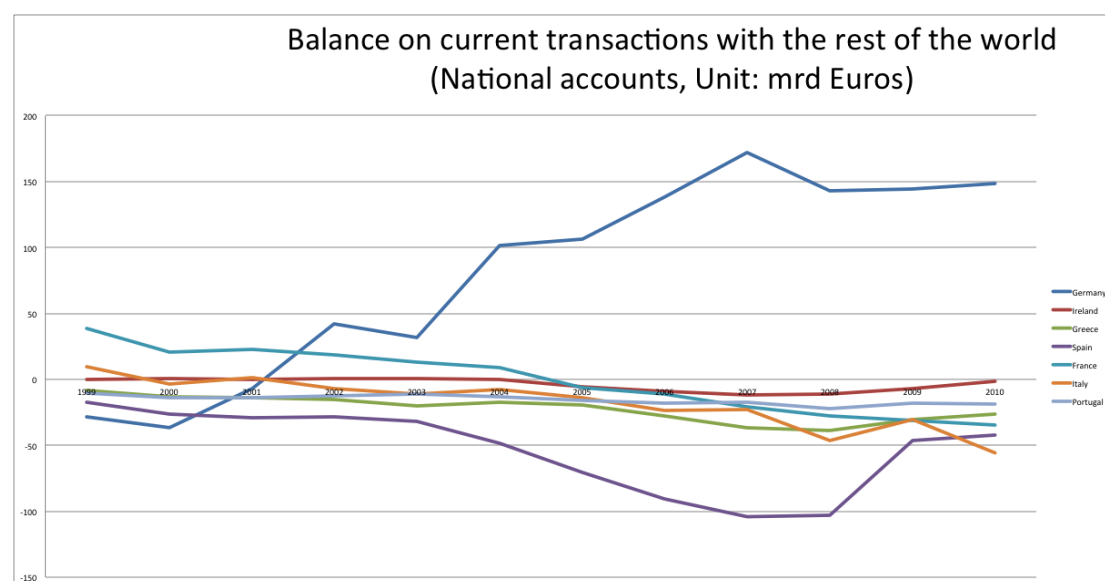
However the analysis of competitiveness below will clarify how the inflationary dynamics of the PIIGS were not related in most cases neither to the performance of real wages nor to that of productivity.



### Competitiveness and the Euro-zone crisis

There is by now a relative consensus in the literature that the Euro-zone crisis was a crisis of competitiveness and not a fiscal crisis (Krugman 2012; Eichengree 2014, DeGrauwe 2013; Bourgeot 2013)<sup>16</sup>. A crisis of competitiveness manifests itself as a current account crisis (Bourgeot 2013), and it is indeed undeniable the trade account and the current account balance of the of the PIIGS experienced an opposite dynamic to the one of Germany, from the start of the EMU up to the outburst of the sovereign debt crisis.

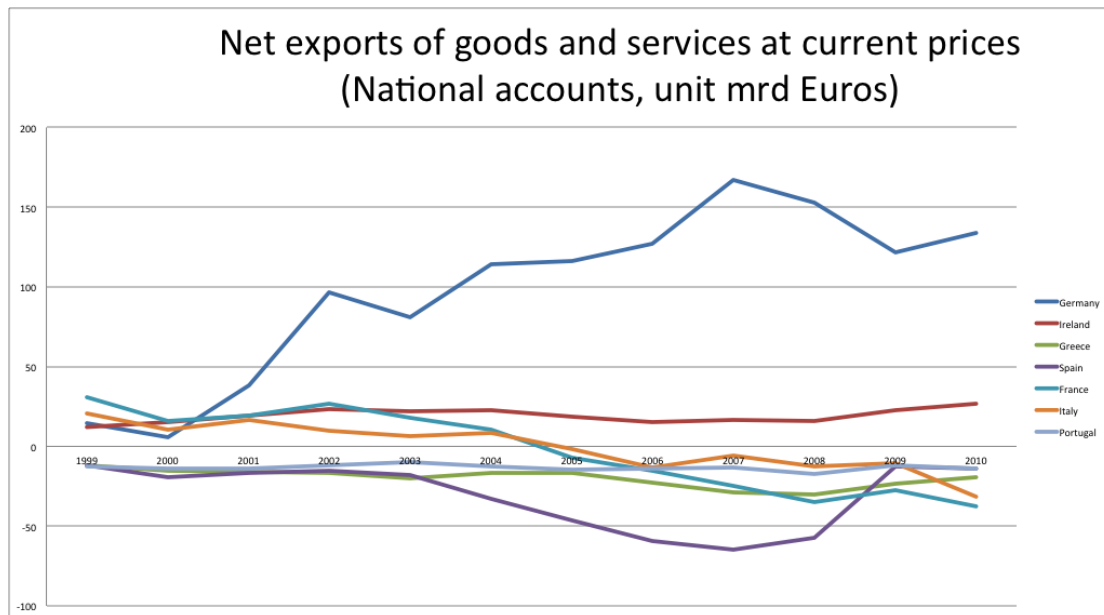
**Figure 4: Balance on Current transactions with the rest of the world**



Source: AMECO

**Figure5: Net exports of goods and services at current prices**

<sup>16</sup> See also Daniel Gros, External Versus Domestic Debt In The Euro Crisis, CEPS Policy Brief No. 243, May 2011.



Source: AMECO

It remains to be discussed, however, what exactly do we mean by a crisis of competitiveness as there are, indeed, various ways to define it and they do bring to different conclusions and even policy proposals.

The most important measure of competitiveness, and the one which is often quoted in the literature, is represented by the Unit Labour Costs (ULC). The nominal ULC are basically given by the ratio between total wages (which are nominal wages) and real GDP. They represent how much it costs on average in terms of labour to produce a unit of real GDP. Another way to calculate nominal ULC is to divide the average wage (total wages over number of employees) for the productivity of one unit of labour (total real GDP divided by the total units of labour of a country).

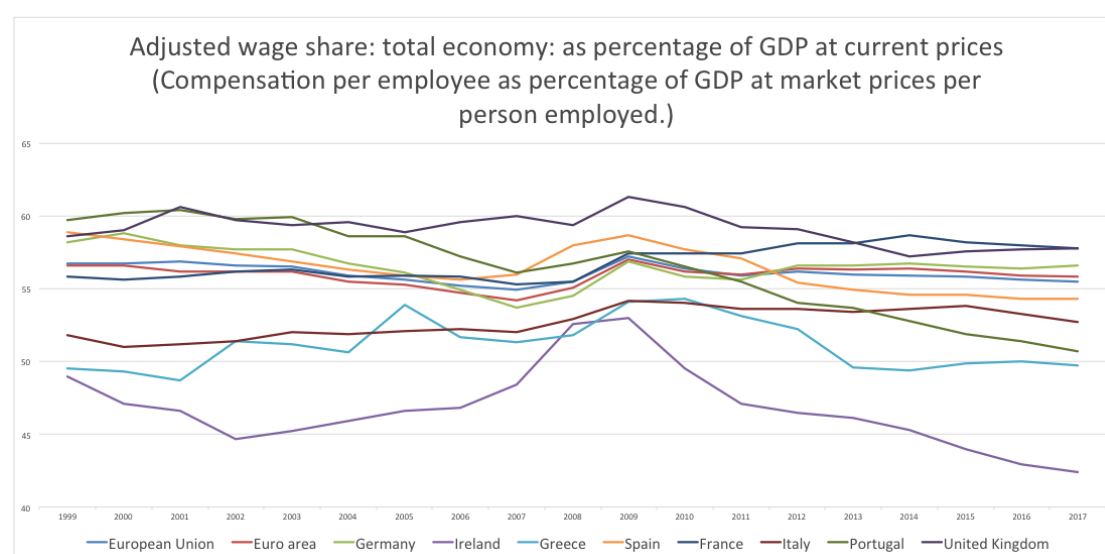
| Definitions of Unit Labour Costs  |
|---|
| 1. Ratio between total nominal wages and real GDP   |
| 2. Ratio between average wage (total wages over number of employees) for the productivity of one unit of labour (total real GDP divided by the total units of labour of a country). |

Given the definition of ULC above it is clear that, although it is true that a country's competitiveness might have been affected by an increase in nominal wages, those are, indeed also a function of the inflation rates. Furthermore, a loss of competitiveness can also be the consequence of a decrease in a country's productivity. Summing up, to correctly assess the factors contributing to a fall in competitiveness, one needs to consider the following indicators: harmonised inflation rates, real costs of labour and productivity levels.

A study by Bourgeot (2013) clearly shows that the divergences in nominal ULCs within the EMU were not a consequence of a wage drift, but of divergences in inflation rates and productivity levels.

Indeed, looking at real unit labour costs, the wage share of GDP experienced a notable decline in peripheral countries between 1999 and 2007, with Spain decreasing by around 7%, almost as much as Germany's 8% after the implementation of Agenda 2010 by Shroeder in 2003<sup>17</sup>. It is also worth noting that the PIIGS, apart from Spain and Portugal, have always had, before, during and after the euro-zone crisis, a wage share of GDP below both the EU average and the average of the Euro zone and also below Germany. Even Ireland, which experienced sharp increase of real wages between 2002 and 2008, always kept much below EU and Euro-zone average and below Germany.

**Figure 6: Adjusted wage share**



**Source:** The European Commission's Ameco online database (data retrieved in January 2016)

<sup>17</sup> In real terms ULCs represent the ratio between total real wage bill and real GDP (or as an equivalent the nominal wage bill and the nominal GDP). Real labour unit costs can therefore be expressed as a share of GDP and not just as variations or as an index number (unlike nominal ULCs). Likewise it can be calculated as the ratio between the average real compensation and real productivity.

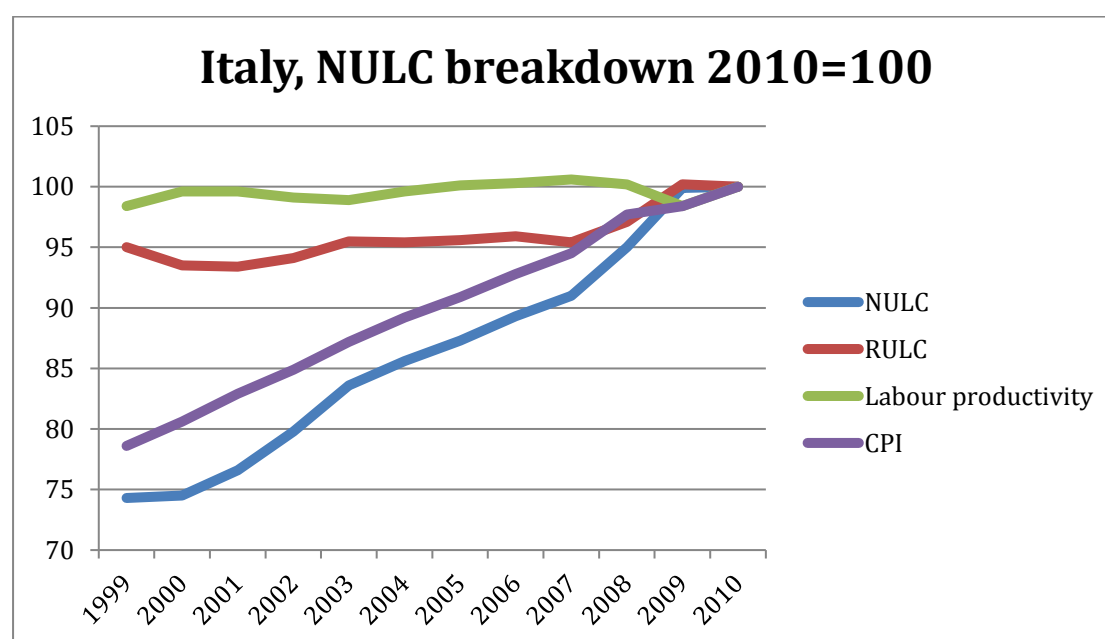
Their variations result from the development of real wages and of real productivity (and exclude inflation). (Bourgeot 2013)

Bourgeot (2013) also notices *passim* that the share of wages has generally declined worldwide in the last forty years because of the falling power of trade unions and the impact of globalization, whereas the share of profits has generally increased for the same reasons (Bourgeot 2013).

So the explanation behind the increase in the Nominal Unit Labour costs needs to be related to the dynamic of inflation rates, which clearly diverged already before the establishment of the EMU. Looking at national consumer price index (CPI), the effects of inflation on the competitiveness of the Euro-zone periphery are undeniable.

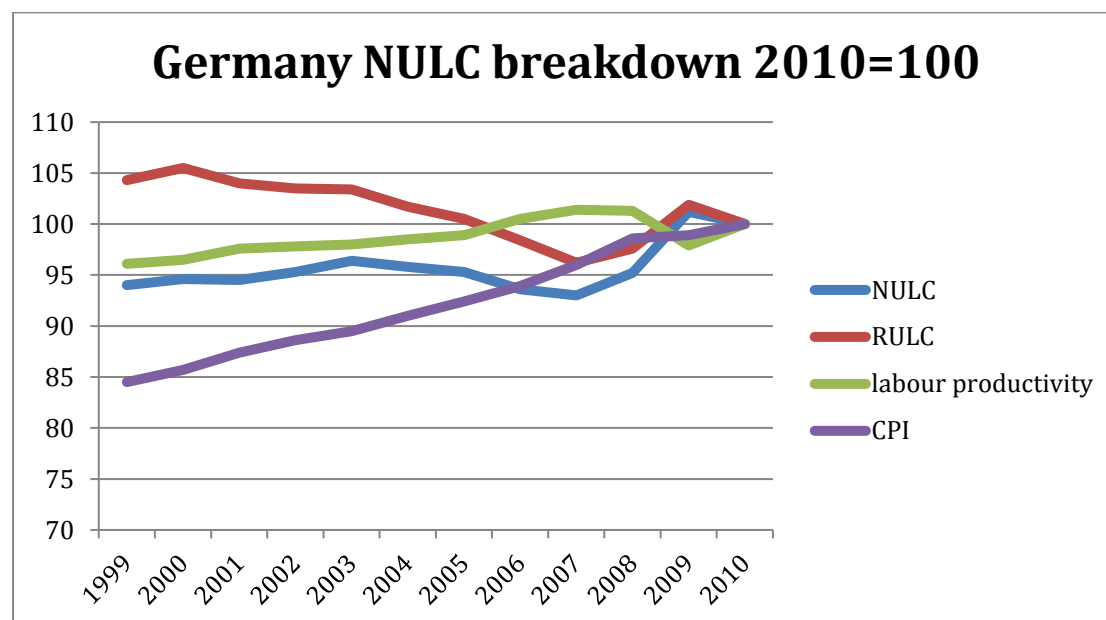
Considering the performance of Nominal Unit Labour Costs, real ULCs, labour productivity and the CPI for each of the countries interested by the sovereign debt crisis and for Germany, the role played by inflation on the crisis of competitiveness emerges clearly. In particular in Italy real ULCs have remained basically stable for all of the EMU period, productivity followed more or less the same trend and this means that the loss of competitiveness can be explained exclusively by the role played by inflation. The same dynamic is clearly recognisable in the case of Greece and even more in the case of Spain, where actually the increase in NULCs and the performance of the CPI coincide. A bit different is the situation in Ireland and Portugal, where the trend is similar but it is possible to notice also a marked increase in labour productivity that kept the RULCs lower. Indeed, a worsening productivity would exacerbate the loss of competitiveness by increasing real ULCs, whereas an increase in productivity would decrease real ULCs (Bourgeot 2013). In contrast, in Germany, NULCs do not seem to have been particularly influenced by the performance of the CPI, which, although increasing, was still far below the CPI of the periphery and therefore it allowed gains in competitiveness with respect to them.

**Figure 7: Italy: NULC breakdown**



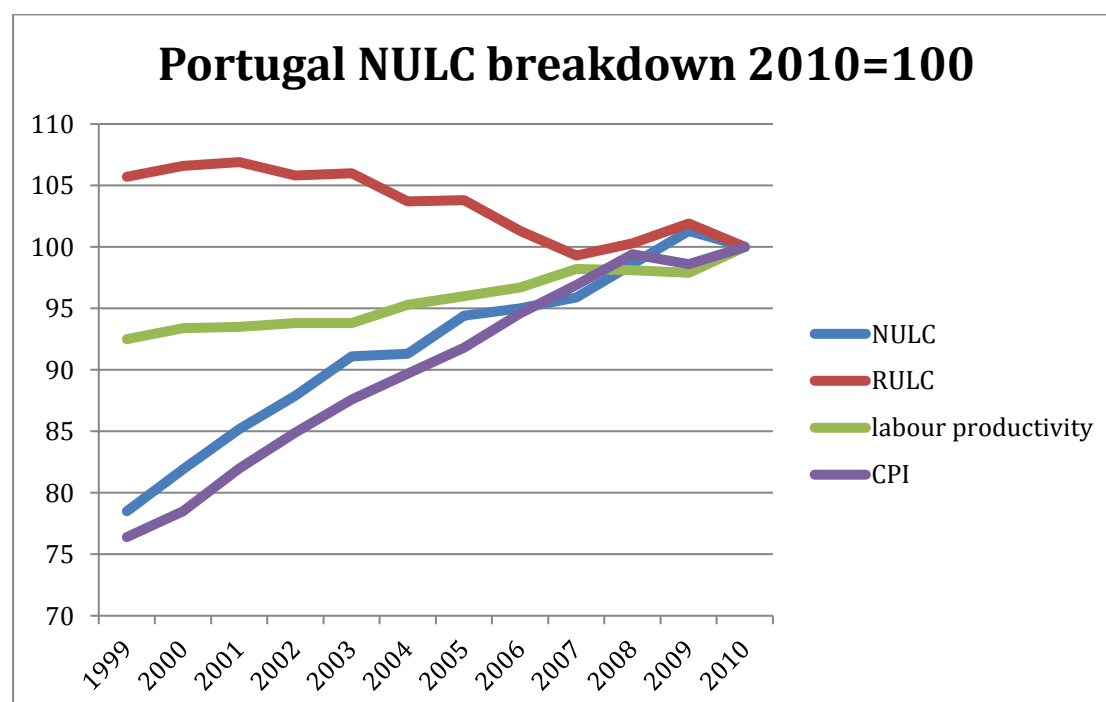
Source: AMECO

**Figure 8: Germany: NULC breakdown**



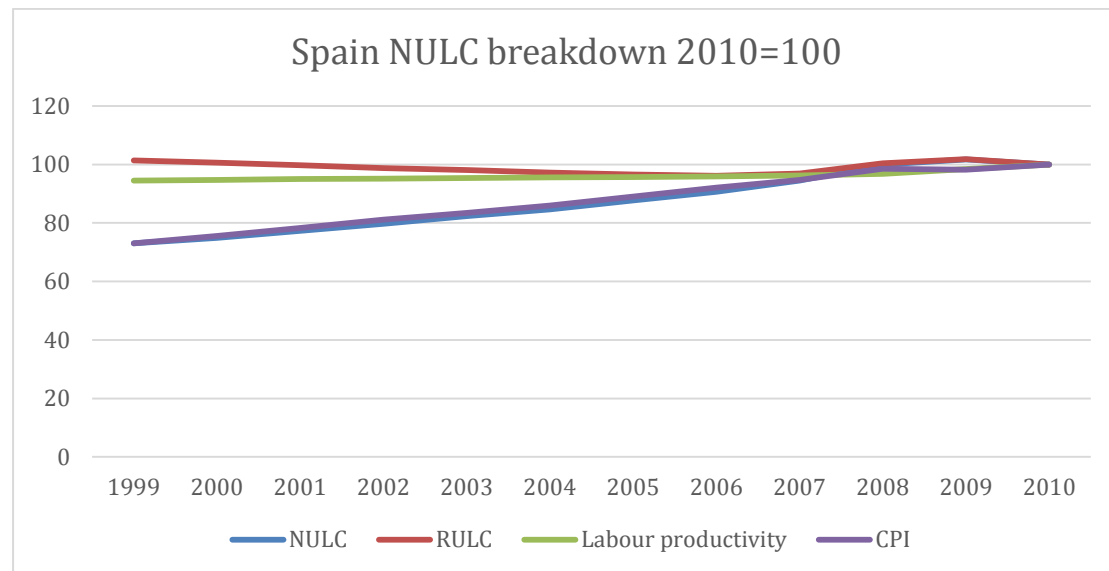
Source: AMECO

**Figure 9: Portugal: NULC breakdown**



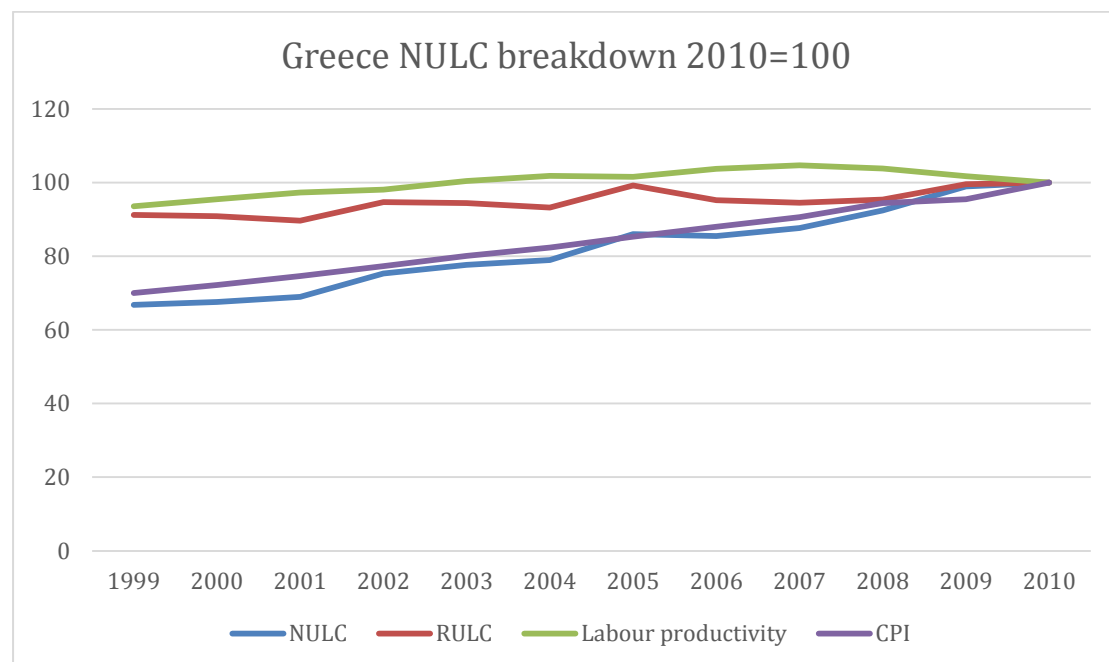
Source: AMECO

**Figure 10: Spain: NULC breakdown**



Source: Ameco

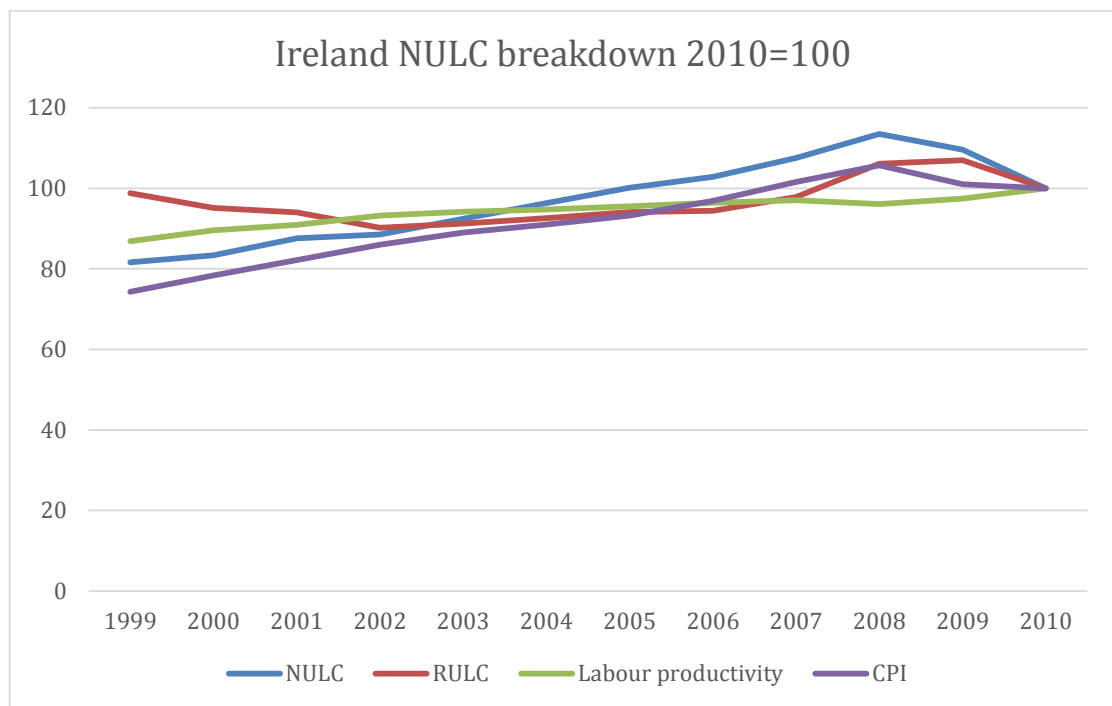
**Figure 11: Greece: NULC breakdown**



Source: AMECO



**Figure 12: Ireland: NULC breakdown**



Source: AMECO

Bourgeot (2013) calculates that it is in the manufacturing sector, the most relevant in terms of competitiveness, where these trends have been particularly striking.

Concluding we need to re-assess this whole question of diverging competitiveness, resulting mainly from divergent inflation performances within the context of the currency Union. As indeed Walters (1990) had rightly noted for the ERM of the EMS, in a fixed exchange rate system and, even more so, in a currency union, the competitiveness lost because of increasing rates of inflation leads, automatically to divergences in the real exchange rates. It must be noted, however, that in the EMU, exactly as in the ERM of the EMS, real exchange rate would not diverge randomly, but would follow the so called 'n-1' country problem. To this, and to the special position of Germany in the EMU, we turn in the next section of this article.

### Germany and competitiveness

In the literature about the relation between the Global financial crisis and Euro-zone crisis two questions seem to be particularly puzzling<sup>18</sup>:

<sup>18</sup> See Manganelli, S. and Wolswijk, G. (2009), "What drives spreads in the euro area government bond market?", *Economic Policy*, 24: 191-240. Argyrou, M.G. and Kontonikas, A., (2010) *The EMU sovereign-debt crisis: Fundamentals, expectations and contagion*, Cardiff Economics Working Paper, N. E2010/9. See also Monfort, A., and Renne, J.-P., (2011) *Credit and liquidity risks in eurozone sovereign yield curves*. Paris: Banque de France Working Papers Series, n. 352. Haugh, D., Ollivaud, P., D. Turner, (2009) *What drives sovereign risk premiums? An analysis of recent evidence from the eurozone*. Paris: OECD Economics Department Working Papers, N. 718. Gerlach, S., Schulz, A. and G.B. Wol (2010). *Banking and sovereign risk in the euro area*. CEPR Discussion Paper, n. 7833. Attinasi, M.G., Checherita, C., and C. Nickel, (2009). *What explains the surge in euro area sovereign spreads during the financial crisis of 2007-09?*. ECB Working Paper Series, n.

The first question is to what extent the financial markets increased the returns they required on sovereign debt because of larger fiscal deficits and debt or because they changed their attitude towards the pricing of government credit risk.

The second question, following from the first, is to what extent increased premiums on risk were the consequence of more risk aversion.

It is indeed evident, as a study conducted by the ECB shows, that financial markets attributed much more importance than before to fiscal imbalances following the collapse of Lehman Brothers in September 2008. More precisely, markets asked coefficients for debt differentials and for deficit ones, respectively 7-8 and 3-4 times higher after the GFC than before.<sup>19</sup>

This means that the markets changed their attitude towards countries with high fiscal imbalances after the crisis and they did so massively, thus demonstrating that there was a clear link between the GFC and the sovereign debt one. Also, increased spreads did not only show the lack of credibility of the government under fire, but also the desire by the markets to put their investment on more secure assets (similarly Krugman 2012). Risk aversion was indeed very sensible in a period in which the stock exchange had collapsed, the housing market was devastated, and the banking sector had just experienced a severe liquidity crisis. In similar circumstances investors were looking for safe havens. These were firstly and fore-mostly represented by commodities, such as gold and oil, to the extent that scholars recognise the commodity price bubble as one of the five phases of the GFC<sup>20</sup>. However, a safe havens investment status was also attributed to the US Treasury Bonds and German euro-denominated ones.

Thus, both increased premiums on fiscal imbalances and increased risk aversion account for much of the increase in the spreads of all EU countries treasury bonds with respect to US and German benchmarks<sup>21</sup>.

If it might be puzzling that the markets had attributed the status of investment safe haven to US government bonds, given that the GFC had started there and that the country was experiencing a huge increase in its debt and deficit to GDP ratios, in the case of the German the reasons are much more understandable.

Indeed, as DeGrauwe (1996:27) had rightly pointed out from before the start of the EMU, Germany had enjoyed, in the course of the whole evolution of the European monetary integration process, a very privileged position.

Germany was, and had already been in the past, the one country of the 'n-1' problem. In other words, precisely because of its anti-inflationary credentials, Germany had been able to set the monetary policy of all the other

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1131. Barrios, S., Iversen, P., Lewandowska, M. and R. Setzer, (2009) *Determinants of intra-eurozone government bond spreads during the financial crisis*. Brussels: European Commission, Directorate General for Economic and Financial Affairs, Economic Papers, N. 388.

<sup>19</sup> Manganelli, S. and G. Wolswijk, (2009) "What drives spreads in the euro area government bond market?" *Economic Policy*, 24: 191-240.

<sup>20</sup> Orlowski, L.T., (2008). *Stages of the 2007/2008 Global Financial Crisis: Is There a Wandering Asset-Price Bubble?*, Economics Discussion Papers, No 2008-43. <http://www.economics-ejournal.org/economics/discussionpapers/2008-43> as accessed on May 18, 2009.

<sup>21</sup> Manganelli, S. and G. Wolswijk, (2009) "What drives spreads in the euro area government bond market?" *Economic Policy*, 24: 191-240.

members of the currency agreement (DeGrauwe 1996:27). To be more precise, in a fixed exchange rate system, like the ERM of the EMS, there are 'n-1' countries, the more inflationary prone ones and, therefore, the ones with the weaker currencies, which will have to use their monetary policy to keep their bilateral exchange rates fixed. On the contrary, one country, the one with the strongest currency, Germany in this case, does not have to worry about the exchange rate, and is free to set its monetary policy independently of exchange rate constraints. Indeed, in the ERM of the EMS all currencies would be depreciated vis-à-vis the DM and therefore, their Central Banks had to ask for very short term lending facilities (VSTLFs) to the Bundesbank and in DM to be able to intervene in the foreign exchange markets to support their bilateral exchange rate. Germany, because of the strength of its DM, was always on the upper band of the system and the BB would de facto provide liquidity to the whole system thus defining the monetary policy for all other members.

Moreover, by needing to keep the nominal exchange rate at a level which is not consistent with the performance of their inflation, the n-1 countries is constantly losing competitiveness. Quite to the contrary, the "one" country improves its competitive stance as it is able to keep the exchange rate at a lower level than the one that would be set if the exchange rate system was flexible. The loss of competitiveness of the 'n-1' countries becomes eventually unsustainable up to the point at which their exchange rate peg loses credibility and the markets can successfully speculate against their currencies.

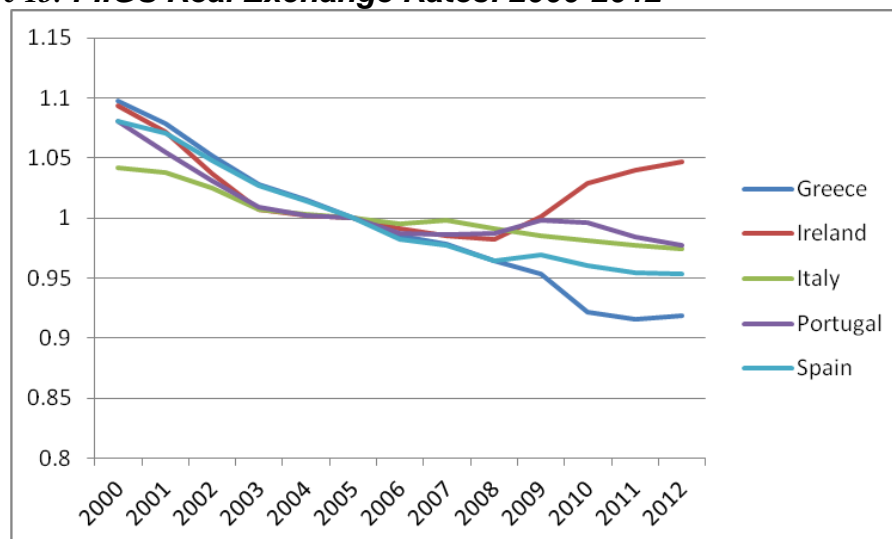
As we have seen in the previous sections, divergent inflation rates, already existing before the establishment of the EMU, did not disappear after the currency union entered into force. In particular, all countries were experiencing inflation rates higher than Germany, exactly as it had been the case within the ERM of the EMS. That can only mean that all countries within the EMU were losing competitiveness vis-à-vis Germany which, by entering the currency union could enjoy a less appreciated currency indefinitely, or at least as long as its inflation performance was better than the rest of the Euro-zone.

Indeed, joining the EMU meant, for the 'n-1', more inflationary countries, progressively increasing their prices at exports without ever being able to devalue the exchange rate. This was particularly serious for the PIIGS which, being particularly inflationary prone, had recurred very often to competitive devaluations in the past. On the opposite side of the spectrum Germany, the 'one' country of the n-1 problem, would progressively and constantly increase its competitiveness not only because of a progressively depreciating currency, but also because it would not have to face competitive devaluations by the other members of the EMU ever again.

Thus, the imbalances which had characterised the previous attempts at monetary integration in Europe were not only reproduced but also exacerbated by the currency Union as established at Maastricht which was therefore characterised by structural asymmetries from the start. This dynamic is reflected in the performance of the power purchasing parity real exchange

rate (RER)<sup>22</sup> of the PIIGS in relation to Germany based on the average consumer price index from 2000–2012 (Figure below). Overall, on the basis of these data, Italy lost some 20% of its competitiveness at exports in the course of its permanence in the EMU, and even higher losses were experienced by Greece and Spain.

**Figure 13: PIIGS Real Exchange Rates: 2000-2012**



Source: IMF, WEO-elaboration of the author

Overall, Germany, by entering the EMU acquired a structural bonus of competitiveness, which increased progressively and might well have been one of the main reasons behind the German decision to give up the DM<sup>23</sup>. On the other hand, the rest of the Euro-zone countries, especially the more inflationary ones, lost competitiveness and were unable to regain it by reverting to competitive devaluations (Similarly Hall 2012; Scharpf 2013). Of course, there is an on-going debate in the field on whether exchange rate devaluations can be considered an optimal way to achieve competitiveness

<sup>22</sup> The formula for the RER used here is given by:  $RER = e (P^*/P)$ , where  $e$  is the nominal exchange rate (1 in the case of the euro-zone),  $P^*$  stands for the international prices index (in this particular case, German prices) and  $P$  is national price index. The data was obtained from the World Economic Outlook Database of September 2011, available on the IMF's website <http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/index.aspx>. Inflation is computed with the average consumer inflation index for all countries. See <http://econapproach.blogspot.it/2011/11/real-exchange-rates-and-eurozone-issues.html> as accessed on December 27, 2012. For a similar analysis see European Commission, Economic and Financial Affairs (2012), Price and Cost Competitiveness, 1-2/2012, Brussels: EC, web-site: [http://ec.europa.eu/economy\\_finance/publications/pcqr/2012/pdf/pccr\\_1\\_2\\_2012\\_en.pdf](http://ec.europa.eu/economy_finance/publications/pcqr/2012/pdf/pccr_1_2_2012_en.pdf), as accessed on December 27, 2012.

<sup>23</sup> Talani, L.S., (2009), *The future of EMU*, London: Palgrave; Eichengreen, B. and Frieden, J. (1994) *The political Economy of European Monetary Union*, Boulder: Westview Press; Frieden, J. (1991) "Invested interests: the politics of national economic policies in a world of global finance", *International Organization*, 45:4, pp. 425-451; Frieden, J. (1994) *The impact of goods and capital market integration on European monetary politics*, Preliminary version, August; Frieden, J. (1998) *The new political economy of EMU*, Oxford: Rowman and Littlefield; Moravcsik, A., (1998) *The choice for Europe*, Ithaca: Cornell University Press

(Malbetta and Schelkle 2015). More emphasis is often placed on 'internal devaluations', which means increasing competitiveness by reducing labour costs, either reducing wages and/or increasing productivity. On similar grounds both EU institutions have often proposed as a solution to problems of growth and employment the increase of labour market flexibility, in all its dimensions. This characteristically means reducing the power of trade unions, as trade unions have historically and institutionally represented the working class in its fight for more job security and higher wages. Thus, simplistically, the rigidities of the labour markets have been equated to the strength of the trade unions and, in turn, this had to diminish in order to resolve the problems of competitiveness of the weaker countries of the system, problems that, as we have just seen, were, instead, structurally embedded in the EMU.

It remains to discuss why, if real wages dynamics do not justify increases in the inflation rates, and productivity performances were not so disastrous in the periphery of the euro-zone, those countries were still experiencing higher prices. One suggestion might be that increases in prices unrelated to decreases of productivity or increases of real wages could be the outcome of a process of catching up which, in a way was not only foreseeable but had even been greeted by European Institutions as one of the main advantages of a monetary union (EC 1990).

Whatever the reasons behind such competitiveness gaps, the reality is that they clearly existed. This precarious equilibrium held until when the markets, with the GFC and the following GEC, realised that the situation was unsustainable.

Arghyrou and Kontonikas (2010) argue that the performance of the spreads in the course of the global financial crisis was due to both an international risk factor, measured by the US Stock Market Implied Volatility (VIX) and a country specific macro factor represented by the loss of international competitiveness.

In other words, both effects were at play: on one side investors wanted safe havens because of the increased risk following from the Global crises. On the other hand, the fundamentals of some countries, both macroeconomic and fiscal ones, that could still be considered acceptable in times of growth, in a more risky environment led the markets to believe that betting against the weakest countries of the system was safe. In the lack of currencies, they started selling the government bonds of the weaker countries dramatically increasing their spreads<sup>24</sup>.

Similarly, Chang and Leblond consider the attack to the sovereign debt of 2010/11 as a speculation by financial markets. However they seem to believe that:

The speculation from early 2010 onward reflects not only the varying economic fundamentals of individual eurozone member states but also, and more importantly, the growing concern for the integrity of the euro area itself. Therefore, Mario Draghi's July 2012 'whatever it takes' pledge to save the euro area ultimately calmed bond investors

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<sup>24</sup> Arghyrou, M.G. and A. Kontonikas, (2010) *The EMU sovereign-debt crisis: Fundamentals, expectations and contagion*. Cardiff Economics Working Paper, N. E2010/9  
 Monfort, A., and J.-P. Renne, (2011) *Credit and liquidity risks in eurozone sovereign yield curves*, Paris: Banque de France Working Papers Series, n. 352.

down in a way that bailouts and the conditionality programmes that accompanied them had not managed to do. Markets sought a large-scale multilateral solution coming from the euro area rather than a unilateral one coming primarily from the debtor countries. Market confidence in the euro area has therefore always rested to a large extent on the expectation of its solidarity. (Chang and Leblond 2014:628)

This interpretation of the motivations behind speculation is untenable because, if the problem was mainly the integrity of the Euro-area, then not only the weakest countries should have been attacked. Also, the reason why the market stopped speculating after the intervention of Draghi in July 2012 is not so much because it signalled to the markets the existence of a euro-zone wide solidarity. It was simply because speculation is impossible if there is a lender of last resort, although imperfect, that basically buys whatever the markets sell. If the ECB buys “whatever it takes”, prices of sovereign debt cannot go down and, therefore, interest rates cannot increase (similarly DeGrauwe 2013).

Summing up, more than a shelter against the worst consequences of the global financial and economic crisis, the EMU, as designed at Maastricht and implemented in the following years proved a highly asymmetric arrangement. It signalled to the markets which countries were unlikely to sustain the economic shock, thus unleashing a run on their sovereign debt.

In the next section we will tackle the question of the reaction of EU institutions to the sovereign debt crisis and why some policies failed while some others, mainly only the monetary policy making of the ECB, succeeded in stopping the markets.

### **Institutional reactions and the issue of the “Lender of last resort”**

As noted above, the n-1 problem, already plaguing the precursor of the EMU, was exacerbated by the loss of monetary policy sovereignty intrinsic in the establishment of a currency union. In a nutshell, if before the adoption of a single currency and a single monetary policy, the n-1 countries of the system could rely on stricter monetary policies than the one country or to straightforward devaluation of their currencies to resolve their competitiveness problem arising from higher inflation rates, with entry in the EMU none of those two tools would be available any longer.

With respect to monetary policy however, although it is true that diverging economic realities do need different monetary policies and that a “one size fits all” might not be enough, it is also true that even a common central bank can, if allowed, effectively intervene to stop financial markets from speculating against the member states of the currency Union (Krugman 2012).

DeGrauwe (2013) rightly pointed out how central banks are essential lenders of last resort to both governments and private financial institutions. Indeed, looking at the case of the UK, a sovereign debt crisis could have never happened because, if the markets had started to sell British bonds, the Bank of England could have always intervened to buy them. This is unfortunately not the case as yet in the Euro-area, so that one of the vital functions of a central bank had to be performed in a “hidden” or disguised way and, crucially, far too late (Krugman 2012).



Unfortunately, indeed, before Draghi was given the all clear to do “whatever it takes” to save the Euro area (Moravcsik 2012), a lot of damage had already been done, and some of it by the EU institutions, which had focused exclusively on the euro-zone crisis as a fiscal crisis and had taken the related fiscal austerity measures to resolve it.

Indeed, the fiscal decisions taken by EU institutions in the wake of the Euro-zone crisis do not configure by any means the establishment of any real fiscal union for the euro-area, contrary to some re-emerging neo-functionalist interpretation<sup>25</sup>. They represent, at best an enhancement of conditional fiscal co-ordination, if not the imposition of fiscal austerity. The first step to react to the massive sale of the PIIGS’ debt financial markets was an ad hoc solution lacking institutional depth and democratic legitimacy: the European Financial Stability Facility (EFSF)<sup>26</sup>. Its institutionalisation in the form of the European Stability Mechanism (ESM)<sup>27</sup> was then approved in December 2010.

On the 9<sup>th</sup> May, 2010, at the start of the speculation against the Greek sovereign debt, the ECOFIN Council deliberated on the establishment of the European Financial Stability Facility (EFSF). The total endowment of the Fund to rescue euro-zone countries in crisis was a mere €750 billion. To assess how small this amount is, it is worth comparing it to the daily turnover of the London FOREX, which is around US\$5.3 trillion per day<sup>28</sup>.

The EFSF was given the possibility to issue bonds guaranteed by Euro Area Member States (EAMS) for up to €440 billion for on-lending to EAMS in difficulty. The lending was, however, heavily conditional to implementing hard austerity programmes negotiated with the (in)famous “troika” of the European Commission, the European Central Bank and the International Monetary Fund and to be approved by the EUROGROUP. The bonds issued by EFSF were awarded triple A credit rating by the usual, influential institutions of Standard & Poor’s, Fitch Ratings and Moody’s. However, the EFSF was a temporary arrangement and, as it failed to limit the run on the sovereign debt of the periphery,<sup>29</sup> in December 2010 the European Council opted for the deliberation of a permanent European Stability Mechanism (ESM). This took two years to be ratified and was finally inaugurated in October 2012<sup>30</sup>. The EFSF was then phased out once the ESM entered into force. The role of the ESM was indeed very similar to the one of the EFSF, namely to provide conditional support to members of the Euro-zone in financial strains. It is

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<sup>25</sup> Schelkle, W. (2013) ‘Monetary integration in crisis: how well do existing theories explain the predicament of EMU?’. *Transfer*, 19 (1): pp. 37-48.; Schimmelfennig, F. (2014) ‘European Integration in the Euro Crisis: The Limits of Postfunctionalism’, *Journal of European Integration*, 36 (3), pp. 321-337; Schweiger, C. (2014) ‘The EU-25 Fiscal Compact: Differentiated Spillover Effects under Crisis Conditions’, *Perspectives on European Politics and Society*, 15(3), PP. 293-304.

<sup>26</sup> See <http://www.efsf.europa.eu/about/index.htm> as accessed on December 15, 2010

<sup>27</sup> For more details, see

[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/118578.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/118578.pdf), as accessed on December 21, 2010.

<sup>28</sup> - See more at: <http://www.cityindex.co.uk/forex-trading/what-is-forex-trading.aspx#sthash.fSDJL6w.dpuf> as accessed on January 20, 2016

<sup>29</sup> See <http://www.efsf.europa.eu/about/index.htm> as accessed on December 15, 2010

<sup>30</sup> The ESM Treaty entered into force on 27<sup>th</sup> September 2012. All seventeen euro area member states had ratified by 3<sup>rd</sup> October 2012.

funded by the issuance of money market instruments and medium and long-term debt with maturities of up to 30 years. The EAMS, in turn, guarantee these assets with capital provided in accordance with the contribution key annexed to the ESM Treaty<sup>31</sup>. The decisions about whether and under which conditions the ESM can intervene to support a country in crisis has to be taken in co-operation with the International Monetary Fund, and EAMS asking financial help to the ESM are requested to address also the IMF<sup>32</sup>. This is already a sign of the limited potential of this mechanism in a situation of serious crisis and indeed scholars have questioned the extent to which a similar mechanism could be effective in rescuing a big member state such as Italy or Spain (DeGrauwe 2012).

Even more clearly in the direction of implementing a strict austerity programme allegedly in response to the euro-zone crisis was the approval by the European Council, on the 2<sup>nd</sup> March, 2012 of the so-called 'Fiscal Compact (officially the Treaty on Stability, Coordination and Governance TSCG<sup>33</sup>). By signing it, governments committed themselves to enshrine the rule of a balanced government budget or in surplus in their own Constitutions. In case of significant observed deviations from the medium-term objective or the adjustment path towards it, the correction mechanism shall be triggered automatically<sup>34</sup>.

The fiscal compact, therefore, cannot be confused with a real fiscal union, not only because the UK refused to sign it to preserve the interests of the City of London as publicly declared by its PM David Cameron. But also, and most importantly, because it does not include any solidarity mechanism, any increase in the common EU budget nor any feature of a true federal budget effectively performing a redistributive and stabilisation function (Ackrill 2000)<sup>35</sup>. In practice, the Fiscal compact is just an even stricter Stability and Growth Pact which had already been toughened by the six pack reform of 2011, constitutionally committing the EAMS signing it to austerity and fiscal restraint.

Moreover the pact does not include any reference to solidarity mechanisms to be activated in case of a serious crisis of one of the euro-area member states. Although on the 22 of June 2015 there has been a joint declaration of the five Presidents of the EU in favour of further steps being taken in terms of integration of the euro-area, including the establishment of a EU Treasury, these will have to be realised by 2025<sup>36</sup> and in the meantime EU institutions can easily change idea<sup>37</sup>.

<sup>31</sup> See ESM website, available at <http://www.esm.europa.eu/about/index.htm>  
As accessed on October 12, 2012

<sup>32</sup> See ESM website, available at <http://www.esm.europa.eu/about/index.htm>  
As accessed on October 12, 2012

<sup>33</sup> For the full text see [http://www.european-council.europa.eu/media/639235/st00tscg26\\_en12.pdf](http://www.european-council.europa.eu/media/639235/st00tscg26_en12.pdf)

<sup>34</sup> Full text available at [http://www.european-council.europa.eu/media/639235/st00tscg26\\_en12.pdf](http://www.european-council.europa.eu/media/639235/st00tscg26_en12.pdf), accessed October 18<sup>th</sup> 2012

<sup>35</sup> De Grauwe, P., (2012), *Interview* available at <http://aregan.wordpress.com/2012/03/20/interview-with-paul-de-grauw/>, accessed on October 18, 2012

<sup>36</sup> See EU web-site [http://europa.eu/rapid/press-release\\_IP-15-5240\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5240_en.htm)  
as accessed on October 22, 2015

<sup>37</sup> Van Rompuy, H., Barroso, J., Juncker, J-C., and Draghi, M. (2012) 'Towards a Genuine and Economic Monetary Union', European Council, Brussels, 26 June 2012 EUCO 120/12.

After this excursus on the mechanisms put in place by the EU Institutions to react to the sovereign debt crisis, it should not surprise that the only effective policy able to stop speculation against the periphery of the Euro-area PIIGS could be the European Central Bank acting as a hidden lender of last resort and an open “saver” of last resort. As already noticed above, this kind of intervention by the ECB has been advocated widely in the literature (Krugman 2012, DeGrauwe 2013; Eichengreen 2014)<sup>38</sup>. Unfortunately, however, the European Central Bank is still far from becoming the official ‘lender of last resort’ of the euro area, as would be natural in any currency union.

Despite this, already in September 2008, with the collapse of Lehman Brothers, the ECB had started intervening by adopting a ‘non-conventional’ monetary policy alongside its standard measures. The non-standard approach to monetary policy inaugurated by Trichet immediately after the GFC became evident, relied initially on two programs: the ‘enhanced credit support (ECS)’ and ‘securities markets program (SMP)’. The first program includes two elements: (a) increasing the share of liquidity supplied at its long-term refinancing operations (LTROs) relative to its regular main refinancing operations (MROs); and (b) increasing the maturity structure of its LTROs. The most important characteristic of this novel approach to monetary policy making is that ECB would provide re-financings on a ‘fixed-rate full allotment’ basis, and not on a variable rate tender format as before. To be clear, this means that, contrary to what happened in normal times, all financial institutions could obtain all the liquidity they wanted at a fixed, and incredibly low, interest rates. In addition, the ECB would accept toxic assets (such as mortgage-backed securities) as collateral in its refinancing operations. Finally, the number of financial institutions eligible to be refinanced by the Eurosystem increased from 140 to around 2000 and they were also protected by anonymity ostensibly to avoid domino effects<sup>39</sup>.

Since 2008, there have been two liquidity providing long-term re-financing operations in Euro with a three year maturity, one maturing on 29 January 2015 and one on 26 February 2015, together with US dollar liquidity providing operations. Similar operations were very interesting for the banking sector as they allowed it to borrow liquidity from the ECB at a very low interest rate and use the money to buy the sovereign debt of struggling countries bearing much higher interest rates, thus profiting from the difference. The consequences of this practice was on the one hand, that a lot of the sovereign debt of the countries in crisis ended up in the balance sheet of the banks, especially of the stronger member states. On the other hand, the banks had no incentive in financing the non-financial private sector, thus exacerbating the length and scope of the recession. For this reason, in June 2014 the EC announced a series of still on-going in 2016 Targeted Longer term refinancing

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<sup>38</sup> Giannone , D., Lenza, Michele, Pill, Huwand Reichlin, Lucrezia (2011), *Non-Standard Monetary Policy Measures And Monetary Developments*, Brussels: ECB Working Paper Series No 1290

<sup>39</sup> Giannone , D., Lenza, Michele, Pill, Huwand Reichlin, Lucrezia (2011), *Non-Standard Monetary Policy Measures And Monetary Developments*, Brussels: ECB Working Paper Series No 1290

operations (TLTROs) aimed at increasing the liquidity of non-financial private actors<sup>40</sup>.

Moreover, always in May 2009, the European Central Bank started a Covered Bond Purchase Programme (CBPP) allocating 60bn Euros to buy both private and state euro-denominated covered bonds issued by EAMS until June 2010. In November 2011 a second Covered Bond Purchase Programme was announced<sup>41</sup>. The second set of non-standard measures initiated by the ECB to react to the crisis, apart from the enhanced credit support measures, was the Securities Markets Programme (SMP) launched in May 2010 at the onset of the Greek crisis. The SMP allowed the Eurosystem to purchase both private and public euro area debt, however this could be done only in secondary markets, fully sterilised and up to a weekly limit, something that, instead of stopping market speculation, might have even stimulated it as by overcoming the weekly threshold just a bit they would beat the ECB and profit from speculation. In fact, only when Draghi announced on 6<sup>th</sup> September 2012 the replacement of the SMP by the Outright Monetary Transactions (OMT), which eliminated any limits to the purchase of bonds in secondary market, the markets stopped going short on the sovereign debt of struggling countries. This happened more than two years speculation had started. In other words, it took more than two year to the ECB to act as a pseudo “lender of last resort” thus managing to put an end to market speculation against the sovereign debt of the PIIGS.

Although the OMT as well were conditional to the implementation of strict austerity measures by Member states in needs, de facto this was not a problem as the OMT in practice did not need to be ever activated. To stop speculation it was enough for the markets to know that the ECB would buy every single bond sold by speculators, thus making profits impossible. This, in the opinion of the author of this article, and contrary to Chang and Leblond (2013) does not signal the start of any solidarity by EU institutions in favour of the weaker countries, but the redressing of an evident anomaly, that is not having a lender of last resort for the Euro-zone.

Moreover, the austerity promoted to react to the sovereign debt crisis ended up in deflation, which signals the contraction of demand and, consequently, the contraction of profits. Also in this case the ECB intervened but, this time without much of a lag, with the quantitative easing (QE) programme inaugurated by the ECB on January 22, 2015. This meant putting 60bn Euros into the system a month until at least September 2016 with the aim of stimulating growth and reversing deflation<sup>42</sup>. This form of intervention has been confirmed and increased to 80bn a month in March 2016<sup>43</sup>.

Regarding this it is important to note that, despite the fact the Euro-area had been in recession for quite some time, QE happened only when the spectre of deflation appeared all over Europe, and not before, when the

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<sup>40</sup> See ECB web-page

<https://www.ecb.europa.eu/stats/monetary/rates/html/index.en.html> as accessed on January 20, 2016

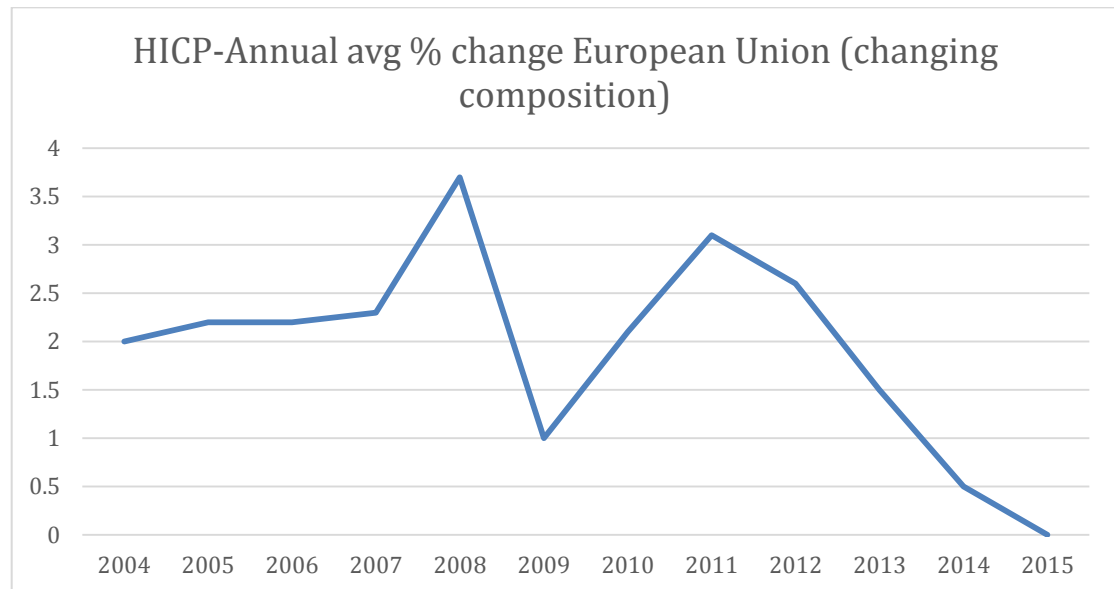
<sup>41</sup> See ECB monetary policy online, available at <http://www.ecb.int/mopo/html/index.en.htm> as accessed on October 18<sup>th</sup>, 2012

<sup>42</sup> See BBC web-site <http://www.bbc.co.uk/news/business-30915210> as accessed on October 22, 2015

<sup>43</sup> See Telegraph on line <http://www.telegraph.co.uk/business/2016/03/10/ecbs-draghi-plays-his-last-card-to-stave-off-deflation/> as accessed on March 21, 2016

burden of the global financial crisis was being shifted to the weaker countries and the weaker strata of the EU. Indeed it was precisely in 2015 that the HICP turned to 0 in the whole of the EU (see figure below).

**Figure -14: HICP Annual avg % Change European Union**



Source: EUROSTAT

### Conclusion:

To conclude, conceptualising the crisis of the Euro-zone exclusively as a fiscal crisis might have led EU institutions to adopt inadequate policy and institutional measures. This contributed to further exacerbate the costs paid by the weakest countries of the system in terms of economic losses and imposition of tough austerity programmes. This is very far from configuring that solidarity between the EU Member States often recalled in the literature which could only be achieved by the establishment of a true federalist fiscal system, a system that, at the moment, is not even at the stage of infancy.

To be sure, the main feature of the EU approach to crisis management was austerity and 'internal devaluation', with all that this mean in terms of increasing inequalities both socially and geographically. This happened despite the rhetoric about the establishment of a new economic governance, or the renewed neo-functionalist credo in the progress towards more integration (Schimmelfennig 2014). As it might be expected this disciplinary attitude did provoke some popular discontent, political instability and disintegration threats whose seeds might produce further crises.

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